amo REPORT

REPORT SERIES 1987

87-11 UNCONDITIONAL GRANTS PROPOSAL FOR 1988

THE ASSOCIATION OF MUNICIPALITIES OF ONTARIO
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ASSOCIATION OF MUNICIPALITIES OF ONTARIO

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The Association acts as the collective voice of Ontario's municipal governments and is organized to accomplish through cooperation and coordination, what the majority have neither the time nor the resources to do individually.

The Association represents some six hundred (600) municipal governments throughout Ontario. The governing body is composed of some eighty (80) municipal elected and appointed officials, who in turn represent a wide-range of municipal government interest.

The following sections and affiliated municipal professional associations form an important part of the Association's structure and therefore, play an important part in its activities in terms of the Board of Directors, program and policy development:

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INTRODUCTION

At the January Board of Directors meeting the members endorsed a list of issues for the Sub-Committee on Unconditional Grants to review for incorporation into the 1988 unconditional grants announcement and for the long term.

1. An examination of including the Police per Household grant in the calculation of the levy base for General Support Grant and Northern Support Grant purposes.

2. An examination of splitting the per household grant between the upper and lower-tier municipalities.

3. Examination of the number of municipalities which are severely affected by caps on the Resource Equalization Grant (REG).

4. Examination of the REG in terms of the 10 percent allocation of funds.

5. Examination of the long term viability of the Revenue Guarantee.

6. Examination of the split in the allocation between levy-based/household-based grants.

7. Examination of the differential in support grants between northern and southern Ontario.

The Association was given a difficult agenda and has, over the past few months, attempted to address many of the issues contained in these recommendations.

The greatest difficulty encountered by AMO was effecting changes that did not cost more than a 4 to 5 percent increase in the previous year's unconditional grants allocation. While many different improvements were attempted, the financial impact of these improvements were prohibitive. AMO appreciates the resource assistance of the Ministry of Municipal Affairs as well as their commitment to improving the current grants structure but has found that the process has been severely limited by a lack funds to the program.

The following proposal for 1988 unconditional grants structure is viewed as an improvement but is still a long way from a solution to the problems inherent in the program.

1. **The Association recommends therefore that the amount of money allocated to the unconditional grants program be increased so that improvements can be made to the program.**

This report is presented in three sections. Section I outlines the Association's recommendations on general policy directions with respect to Unconditional Grants. Section II outlines those issues which are still under consideration by the Association. Section III outlines the Association's recommendations for the 1988 provincial grants structure.

SECTION I -GENERAL POLICY DIRECTIONS

Examination of the Resource Equalization Grant in terms of the 10 percent allocation of funds.

In 1983, AMO responded to the provincial government's discussion paper entitled, "Municipal Cost-Sharing and Unconditional Grants" (AMO Report 83-7) which listed a number of recommendations concerning the structure of unconditional grants. One of these recommendations was that a 40%/10%/50% formula for distribution of the unconditional transfer payment program to the three component parts (General and Northern Support Grants, the Resource Equalization Grant and the Household Grants) be utilized for the 1984 fiscal year only and that AMO and the provincial government continue to work together to develop an equitable and rational transfer payment program formula for 1985 and subsequent fiscal years.

With regard to the REG it was recommended that the allocation be limited to 10 percent for 1984 and be distributed on the basis of the prior year's equalized assessment per household. The rationale for this recommendation stemmed from AMO's and the province's examination of the REG which revealed that a large portion of the REG allocation was misdirected and unsuccessful in meeting the objective of the grant (that is, equalization of the tax base of municipalities throughout Ontario). It was further recognized that equalized assessment per capita (now per household) was a highly imperfect measure of the fiscal capacity of a municipality. In other words, the basic problem with the REG was that the data on which the grant was based, namely equalized assessment, was unreliable. The ultimate transition to market value assessment would however, rectify the situation and produce a more standardized and dependable basis for the grant. Since the basic problem with the grant, (equalized assessment) persists today, AMO urges the government to implement as expeditiously as possible, market value assessment across the province.

Notwithstanding the problems inherent in the REG, AMO in 1983 was concerned that the very poorest of municipalities, those that lacked any measure of fiscal capacity or were in a period of fiscal stress still did require some form of continuing resource assistance. The elimination of the REG was therefore deemed to be unacceptable. Rather, it was felt that the grant should be limited to approximately 10 percent of the total funding for the unconditional program and should be sufficient only to satisfy the needs of the poorest municipalities and not inhibit the growth of the allocation to the unconditional transfer payments.

In 1987, the Association examined AMO's current position, that the REG be limited to 10 percent allocation of funds. In 1987 the REG, together with the Revenue Guarantee consumed approximately 21.5 percent of total unconditional funds (the Reg itself consumed 15.3 percent). This was down from the 1983 level of 28 percent. Reducing the allocation from the 1987 level of 15.3 percent to 10 percent however would cause great shifts among municipalities and in the current structure. In addition, since the Revenue Guarantee protects losses in total unconditional grants, any savings to be had by reducing the REG would be consumed by the Revenue Guarantee and therefore would not be allocated to the levy-based or household-based grants. Since the basis of the grant, namely equalized assessment is still unreliable and will be until all municipalities

undergo market value reassessment, it was felt that the total grant allocation for the REG should not be changed materially from that provided in 1987.

2. **The Association recommends therefore that the Resource Equalization Grant rate be maintained at a rate of 10 to 15 percent of the total unconditional grants program entitlement until such time as municipalities undergo Section 63 (County, Region-wide reassessment) or full market value reassessment in order to make the grants more reliable and standardized.**

Examination of the long term viability of the Revenue Guarantee.

In 1981, the Province introduced a Resource Equalization Grant (REG) guarantee so that no municipality would experience a decrease in REG entitlements. After the release of the provincial discussion paper on grants in 1983, the province replaced the REG funding protection feature with a total Revenue Guarantee. Initially, in 1984 municipalities were granted a minimum increase of 2.5 percent over their 1983 total unconditional grant levels. In 1985, the Revenue Guarantee was set at 2.0 percent over 1984 totals. In 1986, the guarantee for individual municipalities was set to equal the 1985 payment level. In 1987, each municipality in northern and eastern Ontario were guaranteed an increase of five percent with individual municipalities in the rest of the province guaranteed a 2.0 percent increase over their 1986 levels. In 1984, the Revenue Guarantee consumed 7.0 percent of the total unconditional grants program allocation. By 1987, the guarantee had been reduced to 6.2 percent of the total unconditional grants program.

The Association has examined the Revenue Guarantee which illustrates that municipalities which receive the Guarantee are placed in a "shortfall position" in that their total unconditional grant revenues do not keep pace with inflationary or other expenditure increases. In other words many municipalities are locked into a Revenue Guarantee situation where they do not receive increases in total grants year after year. This is illustrated in Table 1.

Table 1 Assumptions

a) The Revenue Guarantee for the year 19X1 is $20,000 due to previous fluctuations in grant entitlements, changes in assessments and households and Revenue Guarantee grant increases.

b) Household grants increase by 1.5 percent per year.

c) Levy based grants increase by 4.5 percent per year.

d) Resource Equalization Grants increase by 5.0 percent per year.

In the first year (19X1), the municipality receives $100,000 in household grants, $100,000 in General Support Grants (levy-based) and $10,000 in Resource Equalization Grants for

TABLE 1 IMPACTS OF THE REVUNUE GUARANTEE

	19X1	19X2	19X3	19X4a	19X4b	19X5	19X6
Household Grants	100,000	101,500	103,022	104,567	104,567	106,135	109,342
Support Grants	100,000	104,500	109,202	114,116	114,116	119,251	130,224
REG	10,000	10,500	11,025	11,576	11,567	12,154	13,399
Natural Entitlement	210,000	216,000	223,249	230,259	230,259	237,540	252,965
Revenue Guarantee	20,000	13,500	6,751		4,341		
Total Guarantee	230,000	230,000	230,000		234,600		

a real entitlement of $210,000. Since grants fluctuated in previous years the municipality was guaranteed an amount of $230,000. That is, no matter what their natural entitlement for the year amounted to, they would receive no less than $230,000 overall. The difference between the $230,000 guaranteed amount and the $210,000 natural entitlement is $20,000. Therefore the Revenue Guarantee amount for the year 19X1 is $20,000.

In the year 19X2, municipalities are guaranteed an amount equal to the previous year, that is $230,000. Households in the municipality increased by 1.5 percent, General Support Grants by 4.5 percent and the REG by 5.0 percent for a total of $216,500 (natural entitlement). Since the municipality is guaranteed the same amount as the previous year it receives $230,000. The difference between their natural entitlement of $216,000 and $230,000 is $13,500. This is the actual Revenue Guarantee amount.

In 19X3 municipalities are again guaranteed an amount of no less than their previous year's entitlement or $230,000. Household grants increased by 1.5 percent, General Support Grants by 4.5 percent and REG by 5 percent for a total of $223,249. Since this figure was below the guaranteed amount as in the years 19X1 and 19X2, the municipality receives $230,000 instead of the natural entitlement of $223,249 for a Revenue Guarantee of $6,751 in 19X3.

In 19X4 the natural entitlement with the same increases in Household Grants, General Support Grants and REG's is $230,259. It is assumed however, that in 19X4, all municipalities are guaranteed an increase of 2 percent. Instead of receiving $230,259 as in scenario 19X4(a) the municipality receives $234,600 (or 2 percent increase on $230,000). Instead of being out of the Revenue Guarantee position as in 19X4(a),the guarantee portion of the grant increases by $4,341. While this is not a problem in the year 19X4(b), a problem is created in 19X5 when the natural entitlement would be $237,540. Since this figure is above the guaranteed amount of $234,600, the municipality receives only its natural entitlement. However, while the increase in the grant from 19X4(b) to 19X5 is only 1.2 percent the municipality is now out of the Revenue Guarantee situation.

If we assume the same increases in the Household Grants, the General Support Grants and the REG for this municipality which is currently out of the Revenue Guarantee situation and project their grants for the following two years, we see the following increases.

In the year 19X6, the natural entitlement for the municipality is $245,105 or a 4.5 percent increase over the previous year's level of $234,600. In 19X7 grants increased by 3.2 percent or to $252,965 based on the same increases.

The previous, somewhat lengthy example illustrates the following points:

- While it is initially beneficial to receive a Revenue Guarantee in a given year it does lessen the grant increases in the following years. In the example, the municipality received no increases in entitlements over three years (19X1 to 19X3). Municipalities are placed in a "shortfall position" in that their grant revenues do not keep pace with inflationary or other expenditures.

- o While the Revenue Guarantee is beneficial for those municipalities which do experience decreases in natural entitlements (ie. loss of assessment or households), once in the guarantee position, it is difficult to get out of this position.

- o It is in a municipality's best interest to be placed in a position, at the earliest opportunity where they do not require a Revenue Guarantee so that their grants will increase in proportion to their rate of growth.

- o In 1987 the Revenue Guarantee consumed 6.2 percent of the total unconditional grants program entitlement. While this grant is beneficial to those municipalities that suffer losses, it does inhibit growth in other grants such as household, levy-based and Resource Equalization Grants.

- o The Revenue Guarantee should not be considered "free money" as there are consequences in the following years.

3. **The Association recommends therefore that municipalities receive a total unconditional grant increase of no less than 50 percent of the overall total percentage increase in the unconditional grants program provided by the province and that this 50 percent be decreased by 10 percent per year for each of five years.**

Examination of the split in the allocation between levy-based/household-based grants.

In the 1983 Report on Unconditional Grants (Report 83-7), AMO considered the split in the allocation between levy-based and household-based grants. Levy-based grants include the General and Northern Support Grants and household-based grants include the General per Household Grant, the Police per Household Grant and the Density per Household Grant.

In 1983, AMO recommended that a blended system incorporating both household-based grants and levy-based grants be developed based on the following characteristics: that the General and Northern Support Grants be retained and form the levy-based component of the transfer payment system and that their rates be established at 6 percent and 18 percent respectively, of the previous year's tax levy. It was further recommended that 40 percent of the total unconditional transfer payments be allocated to these levy-based grants for the 1984 grants year. With regard to household grants, AMO recommended that 50 percent of the unconditional transfer payment program be allocated to the three household grants for the 1984 grants year.

The 1983 examination of the levy-based grants revealed that these two grants were the only progressive and responsive components of the unconditional grants program. In fact, there were only two concerns with these grants. The first was the one year delay in reacting to uneven changes in a municipality's net levy requirements. This was not however seen as a major problem. The other concern which was highlighted in the 1979 Report of the Provincial-Municipal Grants Reform Committee was the need for improvements in the determination of the levy base on which the General and Northern

Support Grants are based. In 1979 one improvement was made, namely the inclusion of revenues resulting from sewer and water user rate charges in the definition of the levy base. In 1986, AMO recommended that the General, Police and Density per Household Grants also be included in the definition of the levy for General and Northern Support Grants purposes. In the 1987 unconditional grant announcement, the Minister of Municipal Affairs adopted AMO's recommendation and included the General per Household Grant and the Density per Household Grant in the definition. While the Police per Household Grant was not included in the 1986 base for 1987 purposes, the Minister did state that it was something he hoped to include in the future. For the 1988 unconditional grants year, AMO is recommending the inclusion of the Police per Household Grant in the definition of the levy base for the General and Northern Support Grants purposes (see Section III recommendations).

With regard to general policy direction, the Association's examination of the levy-based grants has revealed that these grants directly reflect the needs of municipalities as expressed in the expenditure commitments of their elected councils and therefore should represent a large portion of the unconditional transfer payment fund.

Household-based grants on the other hand are not as responsive to the municipality's needs as are levy-based grants since they are not directly related to municipal spending or the level of inflation. They may not therefore, keep pace with the costs of providing municipal services. While household-based grants may be beneficial to many of the rapidly growing municipalities, other municipalities are just as apt to lose as to gain their number of households. In 1987, levy-based grants represented 46.9 percent of the total unconditional grants program allocation. Household-based grants represented 31.6 percent of the unconditional grants program allocation.

4. **The Association recommends therefore that approximately 50 percent of the total unconditional grants program entitlement be directed towards levy-based grants and approximately 40 percent of the funds be directed towards household-based grants and that this allocation be reviewed on a periodic basis.**

SECTION II -ISSUES UNDER CONSIDERATION

Examination of splitting the per household grants between upper and lower-tier municipalities.

At the January Board of Directors meeting, the members requested that the Fiscal Policy Committee consider the viability of splitting the per household grants between upper and lower-tiers. Currently household grants are paid to upper-tier municipalities in regional areas and to lower-tier municipalities within the rest of the province. It should be noted that the province has explicitly stated that any split in the per household grants would be accompanied by a split in payments-in-lieu of taxes and telephone and telegraph revenues.

The Association is still in the process of examining the impact of this change including an examination of; what the split should be (ie. 50/50); which household grants should be split; and if this split is recommended whether or not sharing of payments-in-lieu of taxes and telephone and telegraph revenues which are currently paid to lower-tier municipalities should be standardized between upper and lower-tier municipalities (eg. based on mill rates). Since there is a potential to create great shifts in both the current unconditional grants structure and individual mill rates by this change, the Association wishes to examine the impacts of this scenario further (such as impacts on the REG, and to school boards) before it proceeds with a recommendation.

Examination of the differential in support grants between northern and southern Ontario.

In 1983, AMO recognized that there was a need for additional support for municipalities in northern Ontario. At that time however, AMO recommended a provincial review of the level of support to determine whether the rate of support was appropriate and whether it accurately reflected the cost differential faced by northern municipalities. While there was no doubt considerable variation in costs, it was felt that it may be more appropriate that the cost differentials be reflected in individual program subsidies.

Since that time, the province has not undertaken a review of the differential and as such the issue has once again been placed on the agenda of the AMO Fiscal Policy Committee. In 1987, a special Northern Grants Committee was formed by the Federation of Northern Ontario Municipalities (FONOM) to examine the support grant differential between northern and southern Ontario. Currently municipalities in southern Ontario receive 6 percent of their previous year's net general dollar levy which represents their General Support Grant. Municipalities in northern Ontario also receive a 6 percent General Support Grant plus an 18 percent Northern Support Grant. This in effect gives northern municipalities a grant of 24 percent of their previous year's net general dollar levy.

The special Northern Grants Committee has met on a few occasions this year. It is comprised of four municipal treasurers which includes a representative from AMO who acts as a liaison between groups.

The Special Northern Grant Committee is in the process of; identifying areas to research; estimating research costs; gathering data; and examining avenues for financial support.

SECTION III - RECOMMENDATIONS FOR THE 1988 UNCONDITIONAL GRANTS STRUCTURE

Include the Police per Household Grant in the levy-base used in calculating the General Support Grant (GSG), Northern Support Grant (NSG), and Resource Equalization Grant (REG).

In the context of the unconditional grants program, the levy-base represents the tax requirement which a municipality would have to raise from its ratepayers in the absence of unconditional grants funding. The previous year's levy base is used to calculate the current year's support grants (GSG, NSG). The levy base is the summation of taxation, water billings, sewer surcharges, payments-in-lieu, pre-paid special charges, REG, GSG, NSG (for northern Ontario), and as of last year the General per Household Grant and Density per Household Grant. This figure is not truly reflective of the previous year's requirements as Police per Household Grants which are paid to the municipality are not included in the summation. In order to truly reflect the municipal requirements, the Police per Household Grant should be included in the calculation.

Last year AMO recommended to the province that the three household grants namely, the General per Household Grant, the Police per Household Grant and the Density per Household Grant be included in the definition of the levy base for Support Grant purposes. In the 1987 grant announcement, the Minister did include two of these grants in the calculation of the levy base and stated that "the government will consider expanding the base to include all unconditional grants in future years depending on the availability of funds". The only grant left to include in this calculation is the Police per Household Grant. The rationale for this recommendation is to make levies more truly reflect net municipal expenditures and to reduce the Revenue Guarantee.

5. **The Association recommends, for the 1988 unconditional grants year and subsequent years, that the Police per Household Grant be included in the definition of the levy base for General Support Grant and Northern Support Grant purposes.**

Replace the annual $3 per household REG ceiling with one based on a uniform proportion of unconstrained entitlements.

To understand the effects of this change one must first understand how the REG is calculated.

The first step is to determine the assessment deficiency for a municipality by calculating the proportion by which the municipality's equalized assessment per household is below the provincial standard of $57,000.

EXAMPLE

$$\frac{\text{Provincial Standard per household} - \text{Municipal assessment per household}}{\text{Provincial Standard per Household}} = \text{Assessment Deficiency}$$

or

$$\frac{57{,}000 - 30{,}000}{57{,}000} = .474 \text{ or } 47.4\%$$

The next step is to determine the grant rate by taking 60 percent of the assessment deficiency up to a maximum of 25 percent.

EXAMPLE

Assessment Deficiency X 60 percent = grant rate up to a maximum of 25 percent

or

47.4% X .60 = 28.4%

Since 28.4 percent is higher than the grant ceiling of 25 percent, the municipality's grant rate is 25 percent. This rate is then applied to the municipality's levy. However, the municipal entitlement is further restricted by a $3 per household cap so that the maximum grant payable in any one year cannot exceed the prior year's grant plus $3 per household. The result is that some municipalities receive all of their natural eligibility under the $3 cap while others are constrained by the cap. In other words, the "poorest" municipalities (according to the $3 per household constraint) do not receive their full entitlement. To achieve equity, it is fairer to share the burden amongst municipalities which receive the REG rather than having the "poorest" municipalities suffer the greatest losses.

The Association's recommendation changes the distribution of the $3 per household cap on the REG by removing the $3 per household cap and replacing it with a proportional constraint factor. In other words, the total monies available would be redistributed so

that every municipality which receives the REG would be constrained by the same proportion.

EXAMPLE

If the total REG eligibility is without the $3 cap is	$172,000,000		
and the REG availability is	$125,000,000		
Then the percentage applied to the eligibility of all municipalities would be	$\frac{\$125,000,000}{\$172,000,000}$	=	73%

While one solution would be to remove all caps from the REG so that every municipality received their natural entitlement this would be too costly to implement as the additional funds needed to effect this (27 percent of the unconditional grants program allocation) would have to be taken from the household-based and levy-based grants.

Since some municipalities' REGs increase substantially due to the proposal and since any losses are protected by the Revenue Guarantee, the Association recommends that the REG increases be limited to 10 percent per year. All municipalities which would lose funds due to proportional decreases in the REG will be protected by the Revenue Guarantee and thus no municipality will lose unconditional grants funds from the policy change.

6. **The Association recommends that for the 1988 unconditional grants year and subsequent years that the $3 per household ceiling be replaced with one based on a uniform proportion of unconstrained entitlements and that REG increases be limited to 10 percent per year.**

CONCLUSION

The impact of the recommendations on the unconditional grants structure is illustrated in Table 2.

Overall, household grants increase by 2.1 percent over last year; levy-based increase by 11.7 percent; the REG decreases by 11.5 percent and the Revenue Guarantee decreases by 4.9 percent. This represents a total increase of 4.1 percent over 1987 grants entitlements. (This increase does not reflect the general increases to the Revenue Guarantee as the Association has not been informed of the overall increase in unconditional transfer payments.)

Approximately 30.9 percent of the unconditional grants funds have been allocated to household grants; 50.3 percent to support grants; 13.0 percent to the REG; and 5.6 percent to the Revenue Guarantee.

It should be noted that AMO's recommendations have no impact on the household grants. The recommendations do however; increase the support grants allocation; and decease the REG and the Revenue Guarantee components complementary to the policy directions.

TABLE 2 - 1988 UNCONDITIONAL GRANT

	1987 $000	% of total	1988 $000	% of total
General per Household	106.1	13.0	108.3	12.7
Police per Household	145.9	17.9	149.1	17.5
Density per Household	5.4	0.7	5.5	0.6
subtotal	257.4	31.6	262.9	30.9
General Support	307.5	37.7	343.8	40.5
Northern Support	75.1	9.2	83.5	9.8
subtotal	382.6	46.9	427.3	50.3
REG	125.0	15.3	110.6	13.0
Revenue Guarantee	50.3	6.2	47.8	5.6
TOTAL	**815.3**	**100.0**	**848.6**	**100.0**

Total Unconditional Grants would increase by 4.1%

Note: 1988 figure are projected.

SUMMARY OF RECOMMENDATIONS

AMO recommends that the amount of money allocated to the unconditional grants program be increased so that improvements can be made to the program.

AMO recommends that the Resource Equalization Grant rate be maintained at a rate of 10 to 15 percent of the total unconditional grants program entitlement until such time as municipalities undergo Section 63 (County, Region-wide reassessment) or full market value reassessment in order to make the grants more reliable and standardized.

AMO recommends that municipalities receive a total unconditional grant increase of no less than 50 percent of the overall total percentage increase in the unconditional grants program provided by the province and that this 50 percent be decreased by 10 percent per year for each of five years.

AMO recommends that approximately 50 percent of the total unconditional grants program entitlement be directed towards the levy-based grants and approximately 40 percent of the funds be directed towards household-based grants and that this allocation be reviewed on a periodic basis.

AMO recommends that for the 1988 unconditional grants year and subsequent years, that the Police per Household Grant be included in the levy base for General Support Grant and Northern Support Grant purposes.

AMO recommends that for the 1988 unconditional grants year and subsequent years that the $3 per household ceiling be replaced with one based on a uniform proportion of unconstrained entitlements and that REG increases be limited to 10 percent per year.

FURTHER ANALYSIS

The Association has, over the past two years examined many scenarios in attempts at improving the unconditional grants program. Many of these improvements however are beyond the dollar allocation of the unconditional grants program and therefore many possible improvements have not been effected.

AMO has however developed an excellent understanding of the problems inherent in the program and sees areas which potentially could be improved. Areas of further analysis include; the splitting of the general per household grant between upper and lower-tier municipalities; examining the differential in support grants between northern and southern municipalities; and examining the impacts of the current unconditional grants program on slow growth municipalities.

In addition the Association has developed an excellent working relationship with the Ministry of Municipal Affairs and wishes to continue working with them in attempts at improving the unconditional grants program in the future.

ACKNOWLEDGEMENTS

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The Association would also like acknowledge the members of the Fiscal Policy Sub-Committee for their contributions in developing recommendations for the Unconditional Grants Program.

The members are: Mr. Michael Dietsch, Chairman of the Sub-Committee and Alderman, Town of Niagara-on-the-Lake; Mr. Jack Gartley, Commissioner of Finance and Treasurer, Regional Municipality of Durham; Mr. David Hipgrave, Director, Metropolitan Toronto Management Services Department; Mr. George Skirda, Treasurer, Regional Municipality of Sudbury; and Mr. Robert Rooks, Director of Finance, City of Burlington.

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